sifma

asset management group

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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan)
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Re: Comments with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**")[1] appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the ***Instrument***) and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the ***CP*** and, collectively with the Instrument, the ***Proposed Rule***). The Proposed Rule was published on April 4, 2017 and contemplates a harmonized business conduct regime for OTC derivatives across Canada.

The Proposed Rule would have a significant impact on AMG members, including many that provide asset management services to Canadian clients on a cross-border basis. The full impact of the Proposed Rule is hard to assess absent further details on the proposed registration regime for derivatives advisers which has not yet been released for comment[2]. Given the overlap between

[1] SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed USD $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[2] Proposed National Instrument 93-102 *Derivatives: Registration* (the "**Registration Proposal**").

business conduct standards and registration, SIFMA AMG may have additional feedback on the Proposed Rule once the CSA's registration proposal for derivatives advisers is made available for public comment.

A. General Comments:

1. Most Business Conduct Requirements Should Only Apply to Dealers

SIFMA AMG strongly believes that most of the requirements in the Proposed Rule that apply to both derivatives dealers and derivatives advisers should only apply to derivatives dealers. When an adviser enters into an OTC derivatives transaction on behalf of a client, the transaction is between the client and the executing derivatives dealer. Given that the client is facing the derivatives dealer as principal, there is no need for additional and duplicative business conduct requirements to apply in respect of the transaction simply because the counterparty is represented by an adviser. In particular, we think dealers alone should be subject to the requirements with respect to fair dealing (especially sections 8(1) and (2)), disclosure regarding borrowed money and leverage (section 16), daily reporting (section 22) and statements (section 30). Dealers are best positioned to undertake these responsibilities and the imposition of the same requirements on asset managers would create a duplicative and unnecessary compliance burden.

2. Broad Foreign Adviser Exemption is Required to Minimize Overlapping Rules

SIFMA AMG supports the exemption in section 44 of the Proposed Rule for foreign derivatives advisers whose head office or principal place of business is not in Canada. In the case of the United States, we submit that advisers that are registered with either the Securities and Exchange Commission or the Commodity Futures Trading Commission to provide advice in respect of securities or derivatives or which are otherwise authorized under applicable United States law to provide such advice to persons in the United States should be eligible for the exemption contemplated in section 44.

Subsection 44(3)(a) of the Proposed Rule makes the foreign adviser exemption unavailable unless the adviser is registered in the foreign jurisdiction in which it has its head office or principal place of business. SIFMA AMG submits that the exemption should be available to foreign derivatives advisers that are either exempt from registration or are not required to be registered to act as an adviser in their home jurisdiction. We also submit that these foreign advisers should not have to obtain a separate Canadian exemption from registration in order to be exempt from the business conduct standards in the Proposed Rule. We recommend that the CSA amend Section 44 to reflect this approach and allow foreign firms that comply with the applicable rules of their home jurisdiction to take advantage of the exemption in Section 44 even if they are not registered in the foreign jurisdiction.

We note that the exemption for foreign advisers in Section 44 of the Proposed Rule is not available where the adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. We submit that this restriction should not be necessary and ask the CSA to explain why trading on such an exchange or derivatives trading facility (as an adviser on behalf of clients or otherwise) should make the adviser ineligible for the foreign adviser exemption.

In addition, we believe the exemption in section 44 should be available to foreign advisers that advise both eligible derivatives parties ("EDPs") and non-EDPs. We see no reason why the availability of the exemption should be based on the type of client that is being advised and submit that sub-section 44(1)(a) of the Proposed Rule should be amended accordingly.

As contemplated, the foreign adviser exemption is only available to a derivatives adviser that complies with equivalent foreign laws which will be identified in an appendix to the final rule. In order for SIGMA AMG's members to assess this element of the proposed foreign adviser exemption, it is critical to understand which foreign jurisdictions will be identified in Appendix D to the Proposed Rule and what, if any, residual requirements will apply for each specified jurisdiction. We request that the CSA publish the list of jurisdictions and any applicable residual provisions for consultation in advance of finalizing the Proposed Rule so that our members can provide feedback.

Finally, SIFMA AMG respectfully requests that, in situations where a foreign adviser does not qualify for an exemption from the application of the requirements of the Proposed Rule, the CSA clarify that the requirements contemplated in the Proposed Rule would apply to advisory services provided by our members only to clients located in Canada or organized under Canadian law.

3. *General Advisory Duties Should not be Duplicated in Proposed Rule*

SIFMA AMG does not think a compelling rationale has been provided for requiring separate business conduct standards for advisers solely in connection with derivatives advisory activities. We believe the Proposed Rule imposes duplicative requirements that will increase the compliance burden on advisers without any clear benefits. We are concerned that the Proposed Rule will complicate compliance with well-established fiduciary standards and practices observed by advisers in the context of derivatives and other investing activities. For example, we believe the requirements in the Proposed Rule with respect to conflicts of interest (section 9) and suitability (section 12) already apply to advisers as part of their contractual arrangements with clients and the fiduciary duties that advisers owe to clients under common law. Similarly, we do not see the benefit of requiring specific "know your derivatives party" policies and procedures as contemplated in Section 10(2) of the Proposed Rules; it is general practice for advisers to fulfill appropriate KYC requirements when establishing an advisory relationship and executing an investment management agreement.

To the extent business conduct requirements will apply to advisers which are required to register under the Registration Proposal, we think the CSA should consider amending the relevant provisions of National Instrument 31-103 ("NI 31-103") as appropriate to specifically address derivatives, as opposed to introducing a new set of requirements applicable to all advisers along the lines of the Proposed Rule.

4. *Deviations from International Standards Will Harm Cross-Border Activity.*

A number of the proposed requirements are inconsistent with the regulatory framework applicable to advisers in other major markets like the United States. We are concerned that the regulatory burden associated with these new requirements will reduce the number of foreign advisers willing to provide advisory services to Canadian clients. The proposed senior managers regime is a good example of this. Foreign advisers with a small number of Canadian clients will be reluctant to incur the cost and complexity of implementing such a regime solely for Canadian activity. Similarly, the

recordkeeping requirements in Part 5 of the Proposed Rule are more onerous than the recordkeeping requirement imposed on advisers in major jurisdictions like the United States. Among other things, the Proposed Rule requires records to be maintained for much longer than in other jurisdictions. The significant investment in technology, systems and compliance infrastructure to meet these recordkeeping requirements will be a disincentive to maintaining advisory relationships with Canadian clients. SIFMA AMG asks the CSA to consider whether a sufficient benefit has been identified to justify these significant burdens and costs for market participants.

B. *Specific Comments*:

1. Derivatives Adviser Definition – Business Trigger Factors

SIFMA AMG would ask the CSA to reconsider the factors listed in the CP for determining whether a party is in the business of advising in respect of derivatives. For one, we do not believe the same list of factors should apply for both dealers and advisers. Many of the factors in the CP, such as quoting prices, are never relevant to advisers. Other factors, such as "engaging in activities similar to a derivatives adviser or derivatives dealer", are too open-ended and will make it very difficult to determine and obtain definitive legal advice as to who qualifies as a derivatives adviser.

To avoid any ambiguity, SIFMA AMG believes that the definition of derivatives adviser (and the related portions of the CP) should be amended to expressly exclude (i) professionals whose advisory services are solely incidental to their business or profession (e.g., lawyers, accountants), (ii) otherwise-regulated persons, including derivatives dealers (whether registered or exempt from registration), banks, trust companies and regulated insurance companies and (iii) pension plan sponsors and their affiliates that are providing investment-related services to a Canadian regulated pension fund or subsidiary thereof. Alternatively, these three classes of persons should be exempted from the application of the Proposed Rule.

SIFMA AMG strongly agrees with the inclusion of section 4 of the Proposed Rule, which effectively exempts a person providing derivatives advisory services to an affiliated entity from the Proposed Rule. We submit that the provision should be expanded to exempt the person providing investment advisory services for no compensation to an associated or related person that does not otherwise fall within the definition of affiliated entity for purposes of the Proposed Rule. Alternatively, guidance could be included in the CP to provide clarity that a person providing derivatives advisory services to an associated or related person for no compensation would not trip the "business trigger" for purposes of the definition of "derivatives adviser".

We further submit that it would be helpful to have guidance that a person acting as a manager of investment managers providing derivatives advisory services will not be considered a "derivatives adviser" for purposes of the Proposed Rule solely on the basis that the manager is engaged in hiring, and providing investment guidelines to, third party investment managers.

2. EDP Definition

SIFMA AMG believes it is important that the definition of "eligible derivatives party" include all persons and entities that qualify as "permitted clients" under NI 31-103. While there are differences between the securities and derivatives markets, we do not believe a justification has been identified for excluding any category of "permitted client" from the definition of EDP. Many of SIFMA

AMG's members have already obtained "permitted client" representations from their Canadian clients. If all permitted clients are not also EDPs, our members will have to undertake a significant outreach effort to confirm the status of their Canadian clients for purposes of the Proposed Rule. We submit that such a significant outreach effort is not justified and that the definition of EDP should be drafted in way that allows dealers and advisers to rely on existing representations from their clients as to their status.

SIFMA AMG believes that individuals with minimum net assets of $5 million should be treated as EDPs. We believe a standard based on minimum assets is an adequate indicator of sophistication and provides an objective way for determining which individuals qualify as EDPs. SIFMA AMG does not believe a specific knowledge and experience requirement should apply in order for individuals to qualify as EDPs. We also do not believe that the waiver contemplated in section 7(2) of the Proposed Rule is necessary for individuals who meet the minimum asset test. If the CSA decide to preserve this waiver requirement in the final rule, we submit that it should be a one-time requirement and that the onus should be on the individual to send a revocation notice to their dealer or adviser in the event they want to revoke a previously granted waiver.

SIFMA AMG also believes the two-tiered approach should apply to derivatives advisers when they are advising with respect to managed accounts. We do not support the approach in Section 7(3) of the Proposed Rule which would require derivatives advisers to apply all the requirements of the Proposed Rule for managed account of EDPs. EDPs are sophisticated investors who should not be treated like non-EDPs simply because they have granted discretionary authority to an adviser to execute derivative transactions on their behalf. The need for additional disclosures and protections is no different where the trading decision is client-directed versus at the discretion of an adviser. At a minimum, EDPs receiving advisory services through a managed account should be permitted to waive application of the full set of business conduct requirements in the Proposed Rule so that they are treated like EDPs whose trading decisions are self-directed.

3. *Know Your Derivatives Party*

While we do not believe specific KYC policies and procedures are necessary for derivatives advisers, we would like to highlight section 10(2)(c) of the Proposed Rule as particularly problematic. Section 10(2)(c) would require derivatives advisers, in connection with securities based derivatives, to establish if the party they are advising (i) is an insider of a reporting issuer or any other issuer whose securities are publicly traded or (ii) would be reasonably expected to have access to material non-public information (MNPI) relating to any interest underlying the derivative. While it may make sense to require this information in the context of securities trading, we do not see why this information should be required for derivatives. Given that derivatives (including index based products) can reference many different underling issuers, it would not be practicable for an adviser to collect this information and keep it current. It is also unclear if this information regarding possession of MNPI would need to be assessed each time a derivative referencing an underlying issuer is entered into.

4. Derivative Party Assets

While we agree that advisers should be required to segregate client assets from the adviser's own assets, the Proposed Rule is overbroad in how it would restrict advisers. As part of their discretionary mandate, advisers are generally given authority by their clients with respect to the use

and investment of assets (both in relation to derivatives trading and other activities). For example, advisers are often given authority to post client assets with third parties to margin derivatives transactions. The third party generally has a right of rehypothecation over that collateral under the terms of the relevant credit support documentation. We would ask the CSA to clarify this part of the rule so that advisers are not restricted from fulfilling their discretionary mandates in unforeseen ways.

5. *Referral Arrangements*

In connection with advisory mandates involving derivatives, advisers are often instructed by their clients to identify dealer counterparties and negotiate terms under which the adviser can trade with that dealer on behalf of the client. We would ask the CSA to clarify in the Proposed Rule that establishing a relationship with a dealer on behalf of an advisory client does not constitute a referral arrangement for purposes of the Proposed Rule.

We would be happy to further discuss the issues identified herein at your convenience. If you have any questions, please contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, or Laura Martin at 212-313-1176 or lmartin@sifma.org, or Darren Littlejohn at 416-863-4348 or darren.littlejohn@blakes.com

Respectfully submitted,

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